Supreme Court, U.S.
FILED
DEC 2 - 1999
OFFICE OF THE CLERK

No. 99-597

In the Supreme Court of the United States

STATE OF MINNESOTA, DEPARTMENT OF REVENUE,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether a state tax lien took priority over a federal tax lien that arose before the state taxes were administratively determined and assessed.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-15) is reported at 184 F.3d 725. The opinion of the district court (Pet. App. 16-21) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 7, 1999. The petition for a writ of certiorari was filed on October 5, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On June 2, 1992, a taxpayer named Prime Factors Communications, Inc., filed federal and state employment tax returns for all four quarters of 1991 and the first quarter of 1992. The taxpayer did not, however,

pay the taxes reported on these federal and state returns. The Internal Revenue Service assessed the unpaid federal taxes for those quarters on August 3 and August 10, 1992. On the dates of these assessments, federal tax liens to secure the payment of those taxes arose upon "all property and rights to property" belonging to the taxpayer. 26 U.S.C. 6321. See 26 U.S.C. 6322. On January 14, 1993, the Internal Revenue Service filed a notice of these federal tax liens which reflected that a total federal tax liability of $248,658.33 was then due from the taxpayer. Pet. App. 3.

The Minnesota Department of Revenue (petitioner) processed the taxpayer's state employment tax returns for these same quarters and entered the taxpayer's liabilities into its computer records on August 20, 1992. That was ten days *after* the Internal Revenue Service assessed the federal tax liabilities and the federal tax lien attached to all of the taxpayer's property by operation of federal law. Petitioner determined that the taxpayer's state tax liability for the periods at issue totaled $14,378.32. Pet. App. 3.

On June 21, 1996, certain property that belonged to the taxpayer was sold to a third party. Prior to the closing of this sale, the Internal Revenue Service served a notice of levy directing the closing agent to disburse any funds received on behalf of the taxpayer to the federal government. Pursuant to that levy, the Internal Revenue Service received $14,579.22 of the sale proceeds, which it applied against the taxpayer's obligations. Pet. App. 3.

2. The Minnesota Department of Revenue then brought this wrongful levy action against the United States under 26 U.S.C. 7426, alleging that the state tax lien for the periods at issue was entitled to priority over the federal liens. Petitioner contended that a lien for

state taxes arises on the date of the assessment of the tax (under Minn. Stat. § 270.69(1) (West 1992)) and that state taxes are deemed automatically assessed under state law on the later of the date the return is filed or the date the return is due (under Minn. Stat. § 270.65 (West 1992)). Petitioner claimed that its liens therefore arose on June 2, 1992, the date the returns were filed, and were entitled to priority over the federal liens which arose on August 3 and August 10, 1992. Petitioner relied on *Cannon Valley Woodwork, Inc.* v. *Malton Construction Co.*, 866 F. Supp. 1248 (D. Minn. 1994), in which the district court held on similar facts that Minnesota tax liens held priority over the tax liens of the United States (Pet. App. 4).

The United States argued that petitioner's lien could not have been perfected against the federal liens until petitioner administratively processed the taxpayer's returns on August 20, 1992. Because the federal liens arose *before* that date, the United States contended that the federal liens held priority as first in time. The United States noted that in *In re Priest*, 712 F.2d 1326 (1983), modified, 725 F.2d 477 (1984), the Ninth Circuit held that the "mere receipt" of a tax return under a California statutory scheme similar to Minn. Stat. §§ 270.65 and 270.69(1) (West 1992) was insufficient "to establish a lien that is capable of taking priority over a federal lien." 712 F.2d at 1329.

The district court granted summary judgment to petitioner (Pet. App. 16-21). The court concluded that the state tax lien was perfected upon the mere filing of the taxpayer's returns and was therefore entitled to priority as first in time (*id.* at 19-20).

3. The court of appeals reversed (Pet. App. 1-15). The court held that the state tax liens were not perfected on the date the tax returns were filed because

the Minnesota Commissioner of Revenue is required by state law to take administrative steps to establish the amount of the taxpayer's liability *after* the return is filed (*id.* at 10-11). The court concluded that petitioner's lien was not perfected against the federal liens because petitioner is required to "take some administrative action to acknowledge formally a liability before the amount of the lien can be deemed 'established' and the lien perfected" (*id.* at 11).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Federal law governs the relative priority of the federal tax lien against claims asserted under state law by other creditors of a delinquent taxpayer. *Aquilino* v. *United States*, 363 U.S. 509, 513-514 (1960). Absent any federal statute to the contrary, the priority of the federal tax lien in competition with a state-created lien is governed by the common-law rule that "the first in time is the first in right." *United States* v. *McDermott*, 507 U.S. 447, 449 (1993). A federal standard governs the determination whether a competing state lien is "first in time" for this purpose: a state-created lien is perfected against the federal lien only when there is "nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established." *United States* v. *City of New Britain*, 347 U.S. 81, 84 (1954). The state lien must be "certain as to amount, identity of the lienor, [and] the property subject thereto" to be perfected against the federal lien. *Id.* at 86. A state tax lien satisfies this federal standard

of perfection only when the "assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt." *United States* v. *Vermont*, 377 U.S. 351, 359 (1964) (quoting *Bull* v. *United States*, 295 U.S. 247, 260 (1935)).

The lien claimed by petitioner in this case did not satisfy these federal standards and was not perfected against the federal liens on the date the federal liens arose. The court of appeals therefore correctly concluded (Pet. App. 15) that the federal liens were entitled to priority as "first in time" in this case.

a. Under Minnesota law, taxes shown as due on a return, together with interest and penalties, become a lien upon all of the taxpayer's property within the State "from and after the date of assessment of the tax." Minn. Stat. § 270.69(1) (West 1992). Under state law, "the term 'date of assessment' means the date a return was filed or the date a return should have been filed, whichever is later." § 270.65. For purposes of state law, petitioner's tax lien thus arose on the date that the taxpayer filed its returns (June 2, 1992)—a date that was two months before the federal taxes were assessed and the federal tax liens arose under 26 U.S.C. 6321.

It is well established, however, that state law does not control the priority of the federal lien and that the "characterization of a lien by the State is not, of course, conclusive against the Federal Government." *City of New Britain*, 347 U.S. at 84. See also *United States* v. *Security Trust & Savings Bank of San Diego*, 340 U.S. 47, 49-50 (1950); *Michigan* v. *United States*, 317 U.S. 338, 339-340 (1943). "Local statutory provisions that fix a lien date prior to [the time the lien becomes perfected under the federal standard] must be ignored for the purpose of resolving the federal-state priority ques-

tion." William T. Plumb, Jr., *Federal Tax Liens* 180 (3d ed. 1972)). "Otherwise, a State could affect the standing of federal liens, contrary to the established doctrine, simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax, assessment, etc., is determined." *City of New Britain*, 347 U.S. at 86. A Minnesota tax lien is thus not perfected against the federal lien on the date a taxpayer files a return simply because Minnesota regards that as the "date of assessment" for purposes of state law. The court must still determine whether the state lien satisfies the federal standards of perfection on that date. Pet. App. 9.

The court of appeals correctly held that petitioner's lien did not satisfy the established federal standards. The state lien was not perfected under the federal standards on the date that the return was filed because, on that date, (i) the amount of the lien had not been determined (*City of New Britain*, 347 U.S. at 86) and (ii) the lien was not summarily enforceable in the absence of an administrative determination of that amount (*Vermont*, 377 U.S. at 359).

Minnesota law requires the state tax commissioner to "make determinations, corrections, and assessments with respect to state taxes, including interest, additions to taxes, and assessable penalties." Minn. Stat. § 289A.35 (West 1992). After a return is filed, the state commissioner is required by state law to examine the return and make a determination of the taxpayer's liability. *Ibid.* As the court of appeals correctly held, it is "[b]eyond doubt" that "it is this determination that formally establishes the amount of the taxpayer's liability" under state law (Pet. App. 10).

Minnesota law also specifies that, when such a tax "is not paid within the time specified for payment, a

penalty must be added to the amount required to be shown as tax." Minn. Stat. § 289A.60 (West 1992). When, as in this case, withholding taxes are not timely paid, state law thus requires the state commissioner to add a penalty to the liability. This penalty, along with any interest due on the unpaid liability, is not computed until the tax return is administratively processed. *Cannon Valley Woodwork, Inc.* v. *Malton Constr. Co.*, 866 F. Supp. 1248, 1252 (D. Minn. 1994). As a result, it cannot be said, at the time the taxpayer filed its returns, that there was "nothing more to be done" (*City of New Britain*, 347 U.S. at 84) to determine the amount of the lien and to perfect petitioner's lien under the established federal standard. On the date that the federal liens arose (August 3 and August 10, 1992), the state returns still had to be examined, the state tax liability still had to be determined by the state commissioner, and the delinquency penalty and interest had to be computed and added to the amount of the state tax. The federal liens had priority because, on the dates that they arose, the amount of the state lien was neither "certain" nor "established" by an administrative determination of liability. *City of New Britain*, 347 U.S. at 84, 86.

Contrary to petitioner's claim (Pet. 6-9), the state lien was not summarily enforceable on the dates the federal liens arose. Under Minnesota law, "notice and demand for payment of the amount due" must be sent to a taxpayer before the State may summarily levy upon a taxpayer's property. Minn. Stat. § 270.70(2)(a) (West 1992). As the court of appeals explained (Pet. App. 11), notice and demand for payment "of the amount due" could not be sent until the state commissioner examined the taxpayer's returns, determined the taxpayer's liabilities, calculated the required penalty for non-

payment and interest and added these amounts to the unpaid tax. These were not merely "ministerial acts"; they were instead "substantial contingencies" that had to be resolved through an administrative determination of the amount of the taxpayer's liability "before the state tax liens could be enforced" and before any "levy c[ould] be made" under state law (*ibid.*).*

Petitioner errs in asserting that this interpretation of Minnesota law "mandate[s] the examination and correction of literally millions of tax returns" (Pet. 12). Minnesota law parallels federal law in requiring an official determination of tax liabilities; but neither state nor federal law requires a formal audit for this purpose. Under the state tax practice (like the federal practice), the determination of liability is made by an administrative processing of the return. The state tax commissioner made precisely such an administrative determination of the taxpayer's liability in this case—a determination that was completed on August 20, 1992, shortly *after* the federal tax lien arose upon the assessment of the unpaid federal taxes (Pet. App. 3).

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* Petitioner errs in asserting that its tax liens were "even more readily 'summarily enforceable' than the tax lien that this Court validated in *Vermont*" (Pet. 7). The State's lien in *Vermont* arose "at the time the assessment and demand [were] made by the commissioner of taxes" (*United States* v. *Vermont*, 317 F.2d 446, 447 (2d Cir. 1963), aff'd, 377 U.S. 351 (1964)), and "Vermont * * * could have enforced its lien * * * either by a civil action in the courts or by direct seizure and public sale" (*id.* at 448). Under Minnesota law, petitioner could *not* lawfully have seized the taxpayer's property on the day the taxpayer filed its tax returns (Pet. App. 11), for no administrative determination leading to a notice and demand for payment of the amount due had been made (*ibid.*). The state lien was thus not summarily enforceable prior to the dates on which the federal liens arose.

> By processing the [tax returns], Minnesota took administrative action that established that the taxpayer was liable to the State of Minnesota for unpaid taxes, including the amount of the unpaid taxes and the amount of any penalty and interest.

Cannon Valley Woodwork, Inc. v. *Malton Constr. Co.*, 866 F. Supp. at 1252. As the court of appeals held, it is only upon the completion of that state administrative process that the federal requirement that the amount of the lien be "established" and "certain" is fulfilled (Pet. App. 10-11).

b. Petitioner contends that the court of appeals "ignores * * * reality" (Pet. 8) in requiring the lien amount to be certain, because interest on a tax liability continues to accrue. Petitioner further argues that its liens were, in any event, perfected to the extent of the principal amount of tax due because, upon filing its returns, the taxpayer "made a disclosure and declaration as to the tax it owed" and the amount of that liability was not thereafter changed by the commissioner (*ibid.*).

These contentions are unavailing. The decision of the court of appeals does not negate the principle that a tax return constitutes a declaration by the taxpayer of its asserted liability. Federal law nonetheless requires that "the amount of the lien [be] established" before the state lien can be perfected against the federal tax lien. *City of New Britain*, 347 U.S. at 86. Under Minnesota law, the amount of the lien cannot be determined, and the lien cannot be enforced, until the return is administratively processed and notice of the amount due is issued to the taxpayer (Pet. App. 10-11). Once the lien is thus perfected, interest accrues on that amount by operation of law, and the sort of constant amendment of

the lien postulated by petitioner is not required. See, *e.g.*, *In re Bay State York Co.*, 204 B.R. 277, 282 (Bankr. D. Mass. 1996); *Middlesex Sav. Bank* v. *Johnson*, 777 F. Supp. 1024, 1026 n.3 (D. Mass. 1991).

Contrary to petitioner's claim, the decision below does not render the provision of state law that defines "the 'assessment' as the date of filing * * * utterly superfluous" (Pet. 13). With respect to competing claims under state law, the state statute would presumably govern. The priority of the federal lien, however, is not governed by state law, and the "characterization of a lien by the State is not, of course, conclusive against the Federal Government." *City of New Britain*, 347 U.S. at 84.

2. There is no conflict among the courts of appeals that have interpreted and applied provisions of state law similar to those involved in this case. In the present case, the court of appeals (Pet. App. 11-12) expressly agreed with the conclusion of the Ninth Circuit, applying similar provisions of California law, that a state lien "cannot arise prior to the taking of any administrative steps to establish the lien" and that "[t]he mere receipt of a delinquent State tax return * * * is too vague and indefinite [a standard by which to establish a lien that is capable of taking priority over a federal lien]." *In re Priest*, 712 F.2d at 1329, citing *City of New Britain*, 347 U.S. at 86. Decisions involving similar state laws in other circuits have reached this same conclusion. See, *e.g.*, *Baybank Middlesex* v. *Electronic Fabricators, Inc.*, 751 F. Supp. 304, 310 (D. Mass. 1990) ("in order for the amount of the [State's] lien to be established, there must be 'some activity by the State to fix the taxpayer's liability'") (quoting *In re Priest*, 712 F.2d at 1328); *Brown* v. *Maryland*, 699 F. Supp. 1149 (D. Md. 1987) (the filing of returns is insufficient to

create a perfected lien under the federal standard even though, for purposes of state law, the state lien arose upon the due date for such returns), aff'd, 862 F.2d 869 (4th Cir. 1988) (Table). Review by this Court is therefore not warranted in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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DECEMBER 1999